



[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9678]

RIN 1545-BK99

Mixed Straddles; Straddle-by-Straddle Identification Under Section 1092

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations relating to section 1092

identified mixed straddles established after **INSERT DATE 30 DAYS AFTER**

PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER. The

final regulations explain how to account for unrealized gain or loss on a position

held by a taxpayer prior to the time the taxpayer establishes a mixed straddle

using straddle-by-straddle identification.

DATES: Effective Date: These regulations are effective on **INSERT DATE OF**

PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER.

Applicability Date: For the date of applicability, see §1.1092(b)-6(e).

FOR FURTHER INFORMATION CONTACT: Pamela Lew of the Office of

Associate Chief Counsel (Financial Institutions and Products) at (202) 317-6945

(not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The Deficit Reduction Act of 1984, Public Law 98-369, amended section 1092 of the Internal Revenue Code (Code) relating to straddles. As amended, section 1092(b) instructed the Treasury Department and the IRS to write regulations governing mixed straddles. Regulations governing mixed straddles were issued in 1985, including §1.1092(b)-2T (relating to holding periods and losses with respect to straddle positions) and §1.1092(b)-3T (relating to mixed straddles) (collectively, the 1985 temporary regulations).

This document contains amendments to the Income Tax Regulations (26 CFR part 1) relating to mixed straddles subject to straddle-by-straddle identification under section 1092(b)(2)(A)(i)(I) (identified mixed straddles). On August 2, 2013, the Treasury Department and the IRS published in the **Federal Register** temporary regulations relating to identified mixed straddles (TD 9627 at 78 FR 46807) and a notice of proposed rulemaking cross-referencing the temporary regulations (REG-112815-12 at 78 FR 46854). The temporary regulations added §1.1092(b)-6T, which provides that unrealized gain or loss on a position held prior to the establishment of an identified mixed straddle is taken into account at the time and has the character provided by provisions of the Code that would apply if the identified mixed straddle had not been established. The temporary regulations changed the timing of the recognition of the unrealized gain or loss as compared to §1.1092(b)-3T(b)(6) of the 1985 temporary regulations, which provides that unrealized gain or loss on a position that becomes a position in an identified mixed straddle is recognized on the day prior to establishing the identified mixed straddle.

Section 1.1092(b)-6T applied to identified mixed straddles established after August 1, 2013, the date of filing of TD 9627 in the **Federal Register**. However, in response to comments raising concerns about the immediate applicability date of the temporary regulations, the regulations were corrected on October 29, 2013, to revise the applicability date (TD 9627 at 78 FR 64396 and REG-112815-12 at 78 FR 64430). As corrected, §1.1092(b)-6T would apply to identified mixed straddles established after the date of publication of the final regulations in the **Federal Register**.

Written comments were received on the notice of proposed rulemaking and a public hearing was held on December 4, 2013. All comments were considered and the written comments are available for public inspection at <http://www.regulations.gov> or upon request.

After consideration of all comments, these final regulations adopt the provisions of the proposed regulations with certain clarifications, and the corresponding temporary regulations are removed. The comments and clarifications are discussed in this preamble.

Summary of Comments and Explanation of Revisions

In response to the request for comments in the notice of proposed rulemaking, several comments were received. The comments address three general categories of issues: (1) the immediate applicability date of §1.1092(b)-6T; (2) the character mismatch and timing of gain or loss recognition for assets held by insurance companies; and (3) certain technical rules in the 1985

temporary regulations and the temporary regulations relating to identified mixed straddles.

1. Applicability date

As previously noted, in response to comments raising concerns about the immediate applicability date of the temporary regulations, the regulations were corrected on October 29, 2013, to revise the applicability date. As corrected, §1.1092(b)-6T would apply to identified mixed straddles established after the date of publication of final regulations in the **Federal Register**. The correction notices informed taxpayers that the Treasury Department and the IRS anticipated finalizing the regulations no later than June 30, 2014.

One commenter asked that the applicability date be delayed for at least six months after the publication date of the final regulations in the **Federal Register**.

Because the Treasury Department and the IRS believe that the additional time provided by the correction notices has provided taxpayers with ample notice, these final regulations apply to identified mixed straddles established after **[INSERT DATE THAT IS 30 DAYS AFTER PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**.

2. Character mismatch and timing of gain or loss recognition for assets held by insurance companies

Commenters noted that insurance companies generally are buy-and-hold investors that hold portfolio bonds to maturity absent other events compelling disposition. Bonds held by an insurance company are capital assets and the

interest income generated by those assets is ordinary in nature. Consequently, when an insurance company sells a bond (sometimes pursuant to instructions from a regulator in the case of a bond that has deteriorated in credit quality), the sale may result in a capital loss that does not offset for tax purposes the ordinary income generated by the bond and other portfolio assets. The capital loss may expire unused unless the insurance company recognizes an offsetting capital gain. According to the commenters, the use of the existing regulations to generate capital gains allows an insurance company to avoid the transaction costs, risks of being unable to acquire suitable replacement property, and unfavorable accounting treatment associated with a sale and repurchase of appreciated bonds. The commenters requested that no new regulations on identified mixed straddles be issued because insurance companies rely on the existing regulations to control the timing of capital gain recognition on bonds in their portfolio.

The fact that bonds generate ordinary income on periodic payments but capital gain or loss on disposition (when held as a capital asset) is not unique to insurance companies, and is a fundamental aspect of debt (as well as stock) investments. Section 1092 was not intended to alleviate character mismatches on debt portfolios. The Treasury Department and the IRS believe that using the section 1092(b)(2) identified mixed straddle rules as an alternative to selling or otherwise disposing of a position undermines the realization requirements that generally govern gain and loss recognition. These regulations are therefore being adopted to prevent selective recognition of gains and losses through the

mechanism of an identified mixed straddle even though no disposition has occurred.

3. Technical rules relating to identified mixed straddles

One commenter stated that the 1985 temporary regulations do not define what it means for gain or loss to be “attributable to” a section 1092(b)(2) identified mixed straddle period and asked the Treasury Department and the IRS to modify §1.1092(b)-3T to address this issue. The commenter also requested an amendment to the 1985 temporary regulations to clarify the treatment of a net loss on the disposition of a section 1256 contract when there is an unrecognized gain in the retained non-section 1256 position.

Because these comments pertain to the operation of the 1985 temporary regulations, they are outside the scope of the proposed regulations, and the Treasury Department and the IRS do not believe that it is appropriate to address these comments in these final regulations. These final regulations are intended to address only the time for recognizing gain or loss that has accrued up to the date a taxpayer enters into an identified mixed straddle. All other rules that apply to an identified mixed straddle under the 1985 temporary regulations continue to apply.

The commenter also requested an amendment to the 1985 temporary regulations to clarify whether the rule in §1.1092(b)-2T(c)(2) that resets the holding period on positions in an identified mixed straddle (holding period reset rule) continues to apply under these regulations, even to a position that had been held for the long-term holding period prior to the time the identified mixed

straddle was established. Under the holding period reset rule, when an identified mixed straddle is established, the holding periods of all positions in that identified mixed straddle are reset to zero, and a position does not begin to accrue holding period until it is no longer part of a straddle.

This comment, requesting guidance on the holding period reset rule, is directly relevant to the computations required with respect to accrued gain or loss on a position when a taxpayer enters into an identified mixed straddle. Both the time period before a position becomes part of an identified mixed straddle and the time period after the identified mixed straddle is created are implicated by this comment. To address gain or loss that has accrued up to the day before a taxpayer enters into an identified mixed straddle, the text of §1.1092(b)-6(a) has been revised and a new Example 3 in §1.1092(b)-6(d) has been added to clarify that any gain or loss that would have been a long-term gain or loss under the 1985 temporary regulations will, when recognized, be a long-term gain or loss under these final regulations. To address gain or loss that accrues on or after the day a taxpayer enters into an identified mixed straddle, §1.1092(b)-6(b) expressly provides that §1.1092(b)-2T(a)(1) applies to positions in an identified mixed straddle. Consequently, the holding period reset rule in §1.1092(b)-2T(a)(1) remains applicable to gain and loss that accrues on or after a position becomes part of an identified mixed straddle. As previously noted, the holding period reset rule resets the holding period on positions in an identified mixed straddle to zero and provides that a position does not begin to accrue holding period until it is no longer part of a straddle.

Finally, one commenter requested clarification as to whether unrecognized gain that accrued prior to a position becoming part of an identified mixed straddle is taken into account in determining whether a realized loss is deferred under section 1092(a). Section 1092(a) provides that any loss with respect to one or more positions shall be taken into account for any taxable year only to the extent that the amount of such loss exceeds the unrecognized gain (if any) with respect to one or more offsetting positions. In response to this comment, §1.1092(b)-6(c) and a new Example 4 in §1.1092(b)-6(d) have been added to clarify that the rules of section 1092(a)(3)(A), which include realized gain in unrecognized gain, apply to an identified mixed straddle. Section 1092(a)(3)(B), which applies to identified straddles that are subject to section 1092(a)(2) and includes only gain accrued after the establishment of the identified straddle, does not apply to the section 1092(b)(2) identified mixed straddles that are the subject of these final regulations.

Applicability Date

The final regulations apply to an identified mixed straddle established after **[INSERT DATE THAT IS 30 DAYS AFTER PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure

Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the proposed regulations preceding these final regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small businesses. No comments were received.

Drafting Information

The principal author of these regulations is Pamela Lew, Office of Associate Chief Counsel (Financial Institutions and Products). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entries for §1.1092(b)-6T and by adding entries in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.1092(b)-6 also issued under 26 U.S.C. 1092(b)(1).

Section 1.1092(b)-6 also issued under 26 U.S.C. 1092(b)(2). * * *

Par. 2. Section 1.1092(b)-3T is amended by revising the paragraph heading and the first sentence of paragraph (b)(6) to read as follows:

§1.1092(b)-3T Mixed straddles; straddle-by-straddle identification under section 1092(b)(2)(A)(i)(I) (Temporary).

* * * * *

(b) * * *

(6) Accrued gain and loss with respect to positions of a section 1092(b)(2) identified mixed straddle established on or before **[INSERT DATE THAT IS 30 DAYS AFTER PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**. The rules of this paragraph (b)(6) apply to all section 1092(b)(2) identified mixed straddles established on or before **[INSERT DATE THAT IS 30 DAYS AFTER PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**; see §1.1092(b)-6 for section 1092(b)(2) identified mixed straddles established after **[INSERT DATE THAT IS 30 DAYS AFTER PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**. * * *

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Par. 3. Section 1.1092(b)-6 is added to read as follows:

§1.1092(b)-6 Mixed straddles; accrued gain and loss associated with a position that becomes part of a section 1092(b)(2) identified mixed straddle that is established after **[INSERT DATE THAT IS 30 DAYS AFTER PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**.

(a) Treatment of unrealized gain or loss that arose before a position becomes part of an identified mixed straddle. Except as otherwise provided, if one or more positions of a straddle that is an identified mixed straddle described in section 1092(b)(2)(A)(i)(I) (identified mixed straddle) were held by the taxpayer

on the day prior to the day the identified mixed straddle is established, any unrealized gain or loss on the day prior to the day the identified mixed straddle is established with respect to such position or positions is taken into account at the time, and has the character, provided by the provisions of the Internal Revenue Code that would apply to the gain or loss if the identified mixed straddle were not established. Thus, if a non-section 1256 capital asset was held for the long-term capital gain holding period before the identified mixed straddle was established, any unrealized gain or loss on that asset on the day prior to the day the identified mixed straddle was established will be long-term capital gain or loss when that asset is sold or otherwise disposed of in a taxable transaction. Unrealized gain or loss on a section 1256 contract that accrued prior to the day the contract became part of an identified mixed straddle will be recognized no later than the last business day of the taxpayer's taxable year. For each position, unrealized gain or loss is the difference between the fair market value of the position at the close of the day before the day the identified mixed straddle is established and the taxpayer's basis in that position. See §1.1092(b)-2T and paragraph (b) of this section for the treatment of holding periods with respect to such positions. Changes in value of the position or positions that occur on or after the identified mixed straddle is established are accounted for under the provisions of §1.1092(b)-3T (other than §1.1092(b)-3T(b)(6)). The definitions in §1.1092(b)-5T apply for purposes of this section.

(b) Holding period after a position becomes part of an identified mixed straddle. Section 1.1092(b)-2T(a)(1) applies to any position that becomes part of

an identified mixed straddle, and the long-term or short-term character of any gain or loss on that position that arises on or after the day the position has become a position in an identified mixed straddle will be determined by beginning the taxpayer's holding period on the day after the identified mixed straddle ceases to exist.

(c) Application of the loss deferral rules of section 1092(a). When applying section 1092(a) and §1.1092(b)-3T(b) (other than §1.1092(b)-3T(b)(6)) to any loss that arises while a position is part of an identified mixed straddle, the amount of unrecognized gain includes both unrecognized gains described in paragraph (a) of this section that accrued prior to the day the identified mixed straddle is established and unrecognized gains that arise on or after the day the identified mixed straddle identification was made for the position.

(d) Examples. The rules of this section may be illustrated by the following examples. It is assumed in each example that the positions described are the only positions held directly or indirectly (through a related person or flowthrough entity) by an individual calendar year taxpayer during the taxable year, and no successor positions are acquired or entered into. It is also assumed that gain or loss recognized on any position in the straddle would be capital gain or loss. The following examples assume that the identified mixed straddle is established after the applicability date of this section.

Example 1. (i) Facts. On January 13, Year 1, A enters into a section 1256 contract. As of the close of the day on January 15, Year 1, there is \$500 of unrealized loss on the section 1256 contract. On January 16, Year 1, A enters into an offsetting non-section 1256 position and makes a valid election to treat the straddle as an identified mixed straddle. A continues to hold both positions of

the identified mixed straddle on January 1, Year 2, and there are no further changes to the value of either position in Year 1.

(ii) Analysis. On the last business day of Year 1, A recognizes the \$500 loss on the section 1256 contract that accrued prior to establishing the identified mixed straddle because the section 1256 contract is treated as sold on December 31, Year 1 (the last business day of the taxable year) under section 1256(a). The loss recognized in Year 1 will be treated as 60% long-term capital loss and 40% short-term capital loss. All gains and losses that arise on or after the identified mixed straddle is established are accounted for under the rules of §§1.1092(b)-2T (and paragraph (b) of this section), 1.1092(b)-3T(b) (other than §1.1092(b)-3T(b)(6)), and paragraph (c) of this section.

Example 2. (i) Facts. On December 3, Year 1, A purchases a non-section 1256 position for \$100. As of the close of the day on January 22, Year 2, the non-section 1256 position has a fair market value of \$500. On January 23, Year 2, A enters into an offsetting section 1256 contract and makes a valid election to treat the straddle as an identified mixed straddle. On February 10, Year 2, A closes out the section 1256 contract at a \$500 loss and disposes of the non-section 1256 position for \$975.

(ii) Analysis of pre-straddle gain. A has \$400 of unrealized short-term capital gain attributable to the non-section 1256 position prior to the day the identified mixed straddle was established. This \$400 gain is recognized on February 10, Year 2, when the non-section 1256 position is disposed of. Under paragraph (a) of this section, the gain is short-term capital gain because that would have been the character of the gain if the non-section 1256 position had been disposed of on the day prior to establishing the identified mixed straddle.

(iii) Analysis of straddle gain and loss. On February 10, Year 2, the gain of \$475 (\$975 proceeds minus \$500 fair market value on the day prior to entering into the identified mixed straddle) on the non-section 1256 position attributable to the identified mixed straddle period is offset by the \$500 loss on the section 1256 contract. The net loss of \$25 from the identified mixed straddle is recognized and treated as 60% long-term capital loss and 40% short-term capital loss because it is attributable to the section 1256 contract. See §1.1092(b)-3T(b)(4).

Example 3. (i) Facts. On January 3, Year 1, A purchases 100 shares of Index Fund for \$1,000 (\$10 per share). The Index Fund shares are actively traded personal property and are not section 1256 contracts. As of the close of the day on June 24, Year 2, the fair market value of 100 shares of Index Fund is \$1,200. On June 25, Year 2, A enters into a short regulated futures contract (Futures Contract) referenced to the same index referenced by Index Fund. Futures Contract is a section 1256 contract and A makes a valid election to treat the shares of Index Fund and Futures Contract as an identified mixed straddle. On December 31, Year 2, the fair market value of A's shares of Index Fund is \$1,520 and Futures Contract has lost \$300. On January 10, Year 3, A closes out Futures Contract at a loss of \$400 when the fair market value of 100 shares of

Index Fund is \$1,590. On November 20, Year 3, A disposes of all 100 shares of Index Fund for \$1,600.

(ii) Year 2 analysis. On June 24, Year 2, A has held the Index Fund shares for longer than the long-term holding period, and the \$200 of unrecognized gain on the Index Fund shares as of June 24, Year 2, will be characterized as long-term gain under paragraph (a) of this section when the gain is recognized. On December 31, Year 2, Futures Contract is marked to market under section 1256(a)(1). Under paragraph (a) of this section and §1.1092(b)-3T(b)(4), the loss on Futures Contract of \$300 is netted with the \$320 unrecognized gain on the Index Fund shares that arose while the identified mixed straddle was in place. Because this unrecognized gain is greater than the deemed realized section 1256 loss, the loss on Futures Contract is treated as a short-term capital loss. The loss, however, will be disallowed in Year 2 under paragraph (c) of this section and the loss deferral rules of section 1092(a) because the unrecognized gain in the Index Fund shares that arose while the identified mixed straddle was in place exceeds the deemed realized loss. Even if this gain were only \$250 on December 31, Year 2, the deemed realized loss on Futures Contract would be disallowed because there is \$200 of unrecognized gain in the Index Fund shares from the time A held the shares prior to establishing the identified mixed straddle.

(iii) Year 3 analysis. When A closes out the Futures Contract on January 10, Year 3, the entire amount of the section 1256 \$300 loss that was disallowed on December 31, Year 2, continues to be deferred under paragraph (c) of this section. On November 20, Year 3, A recognizes \$200 long-term capital gain from the pre-identified mixed straddle period, and \$400 short-term capital gain, \$390 of which arose during the identified mixed straddle period and \$10 of which arose after the identified mixed straddle was closed. See §1.1092(b)-2T(a)(1) and paragraph (b) of this section. In Year 3, A recognizes the \$300 short-term capital loss from Futures Contract disallowed in Year 2 and the \$100 loss accrued on Futures Contract in Year 3 because A no longer holds any positions that were part of an identified mixed straddle.

Example 4. (i) Facts. On March 1, Year 1, A purchases a 10-year U.S. Treasury Note (Note) at original issue for \$100, which is the stated redemption price at maturity of Note. As of the close of the day on March 1, Year 3, Note has a fair market value of \$105. On March 2, Year 3, A enters into a regulated futures contract (Futures Contract) that provides A with a short position in U.S. Treasury Notes and A makes a valid election to treat Note and Futures Contract as an identified mixed straddle. A closes her position in Futures Contract on April 15, Year 3, at a \$2 loss. On April 15, Year 3, Note has a fair market value of \$108. On December 31, Year 3, Note has a fair market value of \$106. A holds Note until it matures on February 28, Year 10.

(ii) Year 3 analysis. A has \$5 of unrealized gain attributable to Note prior to the day the identified mixed straddle was established. Because A acquired a long-term holding period in Note by March 1, Year 3, the \$5 of gain will be characterized as long-term capital gain under paragraph (a) of this section when

it is recognized. Under §1.1092(b)-3T(b)(4), when A closes out Futures Contract on April 15, Year 3, the loss of \$2 on Futures Contract is netted with the gain of \$3 on Note that arose while the identified mixed straddle was in place. Because this gain on Note exceeds the realized loss on Futures Contract, the loss on Futures Contract is disallowed in Year 3 under paragraph (c) of this section. Further, under paragraph (c) of this section and section 1092(a)(1), on December 31, Year 3, the disallowed loss of \$2 on Futures Contract cannot be recognized because it is less than the total unrecognized gain of \$6 on Note on December 31, Year 3.

(iii) Year 10 analysis. When Note matures in Year 10, the \$5 of unrecognized long-term capital gain that arose prior to the identified mixed straddle is recognized. Because A receives \$100 upon the maturity of Note, A also recognizes a \$5 long-term capital loss on Note, for a net gain of \$0 (zero). In addition, the termination of all positions in the identified mixed straddle releases the \$2 loss disallowed in Year 3 on Futures Contract. The loss on Futures Contract is treated as short-term capital loss in Year 10 under §1.1092(b)-3T(b)(4).

(e) Effective/applicability date. The rules of this section apply to all section 1092(b)(2) identified mixed straddles established after **[INSERT DATE THAT IS 30 DAYS AFTER PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**.

§1.1092(b)-6T [Removed]

Par. 4. Section 1.1092(b)-6T is removed.

John Dalrymple,
Deputy Commissioner for Services and Enforcement.

Approved: July 1, 2014.

Mark J. Mazur,
Assistant Secretary of the Treasury (Tax Policy).

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